RESEARCH

KAMPALA MARKET UPDATE
H1 2019

Canaan Apartments, Kitante Close

ECONOMIC UPDATE	SECTOR BY SECTOR ANALYSIS	2019 OUTLOOK

HIGHLIGHTS

Annual headline inflation rose to 3.4% in June 2019.

Bank of Uganda maintained the Central Bank Rate (CBR) at 10% in H1 2019.

Ugandan shilling appreciated year on year by 2.9% against the US dollar in June 2019

Loans to the real estate sector increased by 14.2% year on year in May 2019.

Uganda's economy is projected to grow to 6.1% for FY 2018/19.

Occupancy rates in prime residential suburbs of Kampala increased by 9%.

Office market registered a 2% year on year growth in occupancy in H1 2019.

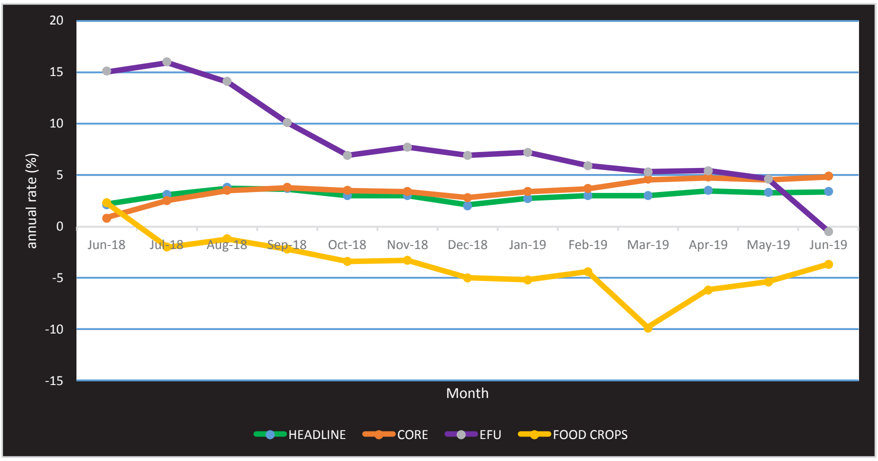
Shoprite opened at The Bugolobi Village Mall, on the 5th April 2019.

KAMPALA MARKET UPDATE **H1 2019**

Inflation

Annual headline inflation increased to 3.4% in June 2019 from 3.3% recorded during the year ended May 2019. The increase in annual headline inflation was largely attributed to the annual core inflation rate, which increased to 4.9% for the year ending June 2019 compared to the 4.6% registered for the year ended May 2019. Food Crop prices rose to -3.7% for the year ended June 2019, up from -5.4% registered for the year ended May 2019. This rise was on account of a -12.2% year on year increase in prices of fruits for the year ended June 2019. Overall, the annual change in prices of goods and services averaged 3.15% for the period January-June 2019 compared to 2.12% recorded for the same period last year.
The developments in inflation for the last 12 months are illustrated in [Figure 1]

Figure 1:
Inflationary rate developments as at June 2019

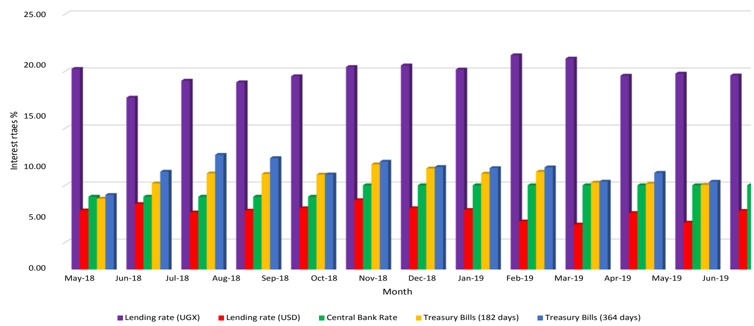


Source: Uganda Bureau Of Statistics

Money Markets

The central bank maintained the key lending rate (CBR) at 10% during H1 2019, given that the inflationary forecasts were stable in the short term albeit accompanying risks were elevated. Commercial bank interest rates were recorded at a weighted average of 20.31% and 7.09% for UGX and USD denominated loans respectively for the period January-May 2019. Year on year, yields on treasury bills declined to 10.06% and 10.26% in June 2019, down from 10.16% and 11.19% registered in June 2018 for 182 and 364-day tenors respectively, reflecting a year on year increase in demand for government securities.
Fig 2 shows the money market trends in H1 2019.[Figure 2]

Figure 2:
Money market trends for the period June-2018 to June-2019



Source: Bank of Uganda

The period "**H1**" refers to the calendar period 1st January to 30th June | **Q1** refers to 1st January – 31st March and **Q2** refers to 1st April – 30th June.

Exchange Rates

On an annual basis, the Uganda shilling appreciated against the US dollar by 2.9% to an average of UGX 3,729.0 per USD in June 2019 from an average of UGX 3,840.5 per USD recorded in June 2018. Monthly, the UGX appreciated by 1.0% against the USD from a monthly average of UGX 3,765.6 in May 2019. For the period January-June 2019, the UGX slightly depreciated against the USD by an average of 0.1%. The depreciation pressure for the period January-May 2019 is largely attributed to the high demand for foreign currency for imports on account of high trade activity. [Figure 3]

Private Sector Credit to the Real Estate Sector

Credit advanced by commercial banks to the real estate sector comprising building, mortgage and construction increased by 14.2% year on year to approx. UGX 2.9 trillion recorded in May 2019. The annual growth in credit extended to the real estate sector can be attributed to an improvement in asset quality as evidenced by lower non-performing loans, with the ratio of Non-Performing Loans to total loans (NPL ratio) recorded at 3.82 in March 2019 compared to 5.30 registered during the same period last year.
It's important to note that the mortgage subsector accounted for approx. 43% of the private sector credit disbursed by commercial banks as at end of May 2019. [Figure 4]

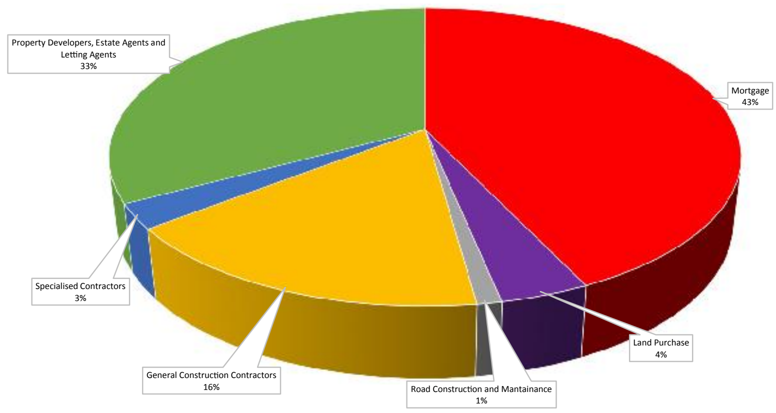
ECONOMIC GROWTH

According to the 2019/20 budget Speech, Uganda's economy was projected to grow by 6.1% in the Financial Year 2018/19. The key drivers for the economic growth were; increased private and public sector activity, the stability of the global economy and improved weather conditions. The size of Uganda's economy was recorded at approx. US$ 29.5 billion. In terms of sector contributions, services, industrial and agriculture sectors registered positive growth of 7.2%, 5.8% and 3.8% growth during FY 2018/19 [Figure 5]

Figure 3:
UGX vs USD exchange rate trends for the past 12 months

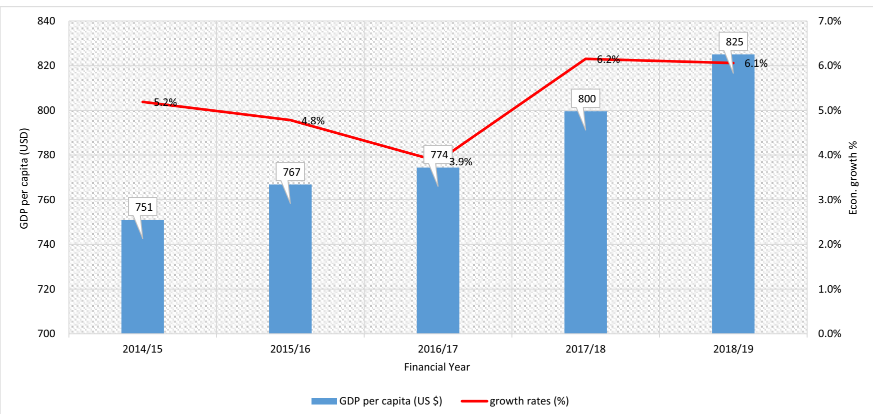
Source: Bank of Uganda

Figure 4:
Breakdown of loans extended to the private sector as at May 2019



Source: Bank of Uganda

Figure 5:
GDP growth and Per Capita at constant 2009/10 prices



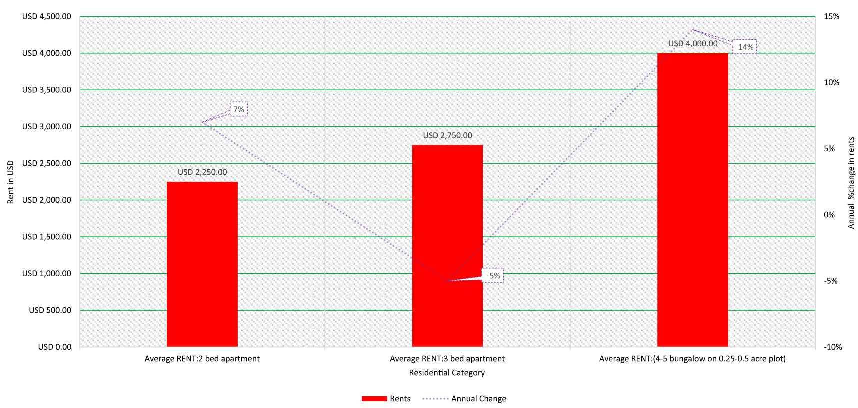
Source: Uganda Bureau Of Statistics

RESIDENTIAL

Occupancy rates for prime residential suburbs of Nakasero, Kololo, Naguru, Mbuya and Bugolobi increased from 69% recorded in H1 2018 to 78% in H1 2019. Knight Frank also recorded a 7% increase in rents for 2-bedroom apartments from an average of USD 2,100 registered in H1 2018 to USD 2,250 in H1 2019. This is due to demand outstripping supply as evidenced by an increase in expatriate accommodation for singles and couples for 2 –bedroom units.

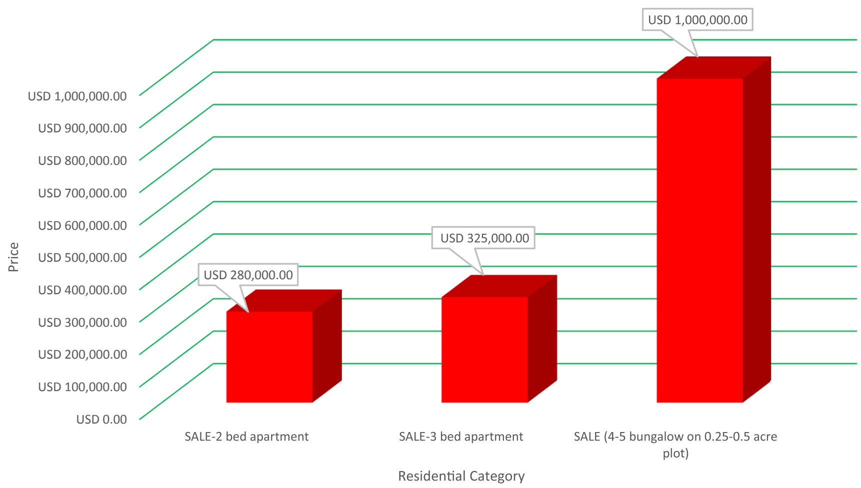
On the other hand, Knight Frank Research registered a 5% decline in average rents for 3-bedroom apartments from USD 2,900 recorded in H1 2018, down to USD 2,750 in H1 2019. This is mainly attributed to supply outstripping demand for 3-bed units. Demand for modern stand-alone houses in the prime residential suburbs also increased for the period under review. This, coupled with the fact that the majority (90%) of existing detached houses are old and due for refurbishment led to a 14% year on year increase in rents for stand-alone houses in H1 2019. Above all, the overall supply-demand disequilibrium of apartment units led to an average annual decline of 3% and 4% in sales prices for 2 and 3-bedroom units respectively in H1 2019. [Figure 6]

Figure 6:
Average residential rents and occupancy rates in prime residential areas



Source: Knight Frank Research

Figure 7:
Average residential sales prices in prime residential areas of Kampala



Source: Knight Frank Research

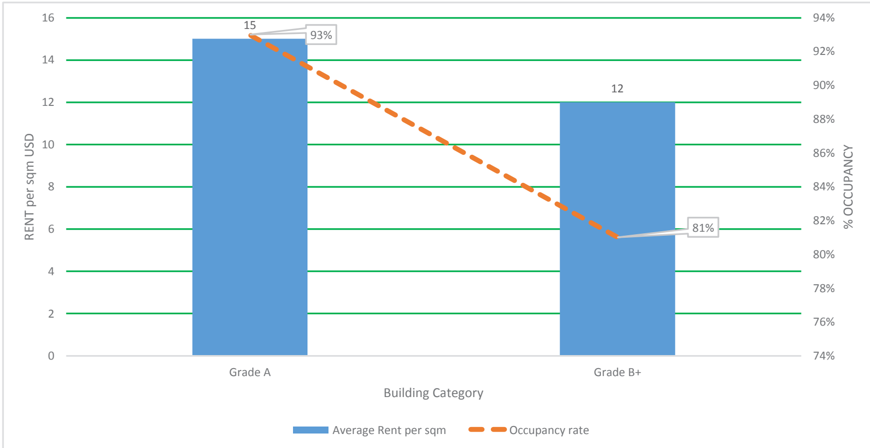
OFFICE

The Kampala office market registered a 2% growth in occupancy from H1 2018 to H1 2019. This growth is mainly attributed to a 3% increase in occupancy rates for Grade B+ buildings from 78% registered in H1 2018 to 81% in 2019. The increase in occupancy of Grade B+ properties is on account of tenants taking advantage of a soft office market at present to drive harder bargains for lower rentals, particularly for less prime properties. Other key drivers of office take-up include good location and accessibility, ample parking, space configuration and functionality, professional property management services as well as the quality of services and facilities at the properties for rent.

Knight Frank recorded a 1% increase in occupancy rates for Grade A properties from 92% registered in H1 2018 to 93% in H1 2019. The addition of approx. 18,000 sqm of Grade A lettable space in H1 2019 is expected to have a negative impact on occupancy rates for Grade A space in the second half of 2019 if existing supply does not meet demand. Whereas office take-up has seen some upward movement over the last 6 months, in H2 2018, a number of Grade A and B+ buildings experienced vacancies from government agencies and a few multinational companies that moved into owner-occupied built to suit premises. This increased the available supply of space on the market, mainly in the grade B+ and B office type, further increasing the bargaining strength of prospective tenants. This, in turn, led to a 5%-10% decrease in achievable rents.

Approx. 11,000 m^2 of office space was leased in H1 2019, with legal services, logistics, tour & travel and insurance firms accounting for 20%, 20%, 12% and 12% of the space leased respectively. Yields for Grade A office space were recorded at 9%-10% while those for Grade B office space varied between 10%-11%. (Figure 8)

Figure 8:
Prime office rents excl. S/C and occupancy



Source: Knight Frank Research

NB: The rents indicated above are exclusive of service charge and VAT which usually ranges from $2-$5 depending on the specific features of the building.

Course View Towers, Plot 21 Yusuf Lule Road. Space available to let.

VALUATION

Knight Frank recorded a 28% year on year increment in valuation instructions. This positive growth is mainly attributed to a 45% increase in commercial instructions which was higher than residential instructions received. Additionally, the overall positive increase in instructions is in correlation with the 8% annual growth in private sector credit disbursed by commercial banks for mortgage borrowers by the end of April 2019.

Table 1:
Breakdown of Bank Instructions H1 2018 vs H1 2019

Instruction Trends	H1 2018	H1 2019
Residential	57%	51%
Commercial	43%	49%

Source: Knight Frank Research

RETAIL

Shoprite opened their fifth store in Uganda at The Bugolobi Village Mall, on the 5th April 2019. This was a unique opening for a major retail store as the norm is usually to open in the third or fourth week of a month, in order to capitalize on the month-end trade.

The Shoprite store opening was well received by the primary catchment market with average weekly footfall increasing by 85% during the opening week compared to the same period in H1 2018. This shows the depth of the consumer base in the Bugolobi node and bodes well for the pending tenant mix redevelopment of Village Mall. The redevelopment will see Cafesserie and Lintons open in the mall in the second half of this year and the first level of the Mall undergoing a re-development into a fashion and entertainment wing with Bata already confirmed as an entrant.

Metroplex Mall in Naalya was sold to Gateway Delta. The deal brokered by Knight Frank will be followed by redevelopment of the mall by the Mauritian based company to give it a new look and feel. The new Metroplex will be anchored by Carrefour, the French supermarket brand which will be operated by MAF, a Dubai based holding Company with numerous outlets already trading in Kenya as well as across the Middle East. The Metroplex Mall will retain Woolworths as a key fashion retailer, but also offer an upgraded cinema complex and a new access road into the mall. Phase one of the mall is expected to open in the first half of 2020. Carrefour has also confirmed their opening at Oasis Mall in the CBD in December 2019.

Knight Frank managed retail portfolio registered an average 7% year on year increase in occupancy from 80% recorded in H1 2018 to 87% recorded in H1 2019 driven by an increase in enquiries for space, majority of which are coming from international based retailers specifically in the fashion sector.

Retail rental rates have remained stable in the past 12 months and prime market-related rentals in malls are as per. (Table 2)

Whilst the table above shows rental rates for prime ground floor space in Malls, it is interesting to note the growth in flow through rentals at suburban developments in the city have increased by 4.6% from USD 21.81 recorded in H1 2018 to USD 22.86 per m^2 registered in H1 2019.

Flow through rentals are the average rental per m^2 in a development. This relates to secondary space in malls achieving slightly higher rentals as consumers continue to transition away from CBD shopping into suburban malls, as retailers seek to leverage on this trend by opening stores in the malls, therefore creating demand for space and increasing rental rates. The figure is also reflective of escalation rates which vary between 3% and 5% on dollar-based rental transactions. This escalation in rentals is also in line with annual headline inflation. The fact that these figures are all closely aligned shows the maturity and self-regulation in the local retail development sphere were both astute landlords and tenants' contract on a willing buyer willing seller model.

Table 2:
Prime Retail Rental Rates in Kampala

Size	Rates
<10m^2	\$200
<50m^2	\$48
<100m^2	\$28
<500m^2	\$23
>500m^2	\$20.00
>1000m^2	\$14.50

Source: Knight Frank Research

NB: These figures are average rentals for ground floor space in Kampala Shopping Malls but do not take Shop front to depth ratio into account and exclude service charge.

The Village Mall, Plot 47A Spring Road, Bugolobi. Space available to let.

OUTLOOK FOR H2 2019

Economy

According to the International Monetary Fund's (IMF) Article IV Consultation report for Uganda released in May 2019, Uganda's economy is projected to keep the growth momentum in the range of 6%-7% in the medium term on condition that infrastructure and oil sector investments proceed as planned. However, regional tensions and weather-related shocks such as drought remain key risks to the outlook.

Office

We anticipate a 3%-5% reduction in occupancy rates for Grade A office space due to the addition of approx.20, 000 m2 of lettable space based on the average absorption rate of approx. 11,000 m2 per 6 months. However, we expect net rents and yields to remain stable at an average of USD 15.5 per sqm and 9.5% respectively. Core drivers will continue to gravitate towards the location and building amenities.

Furthermore, we expect demand for co-working space to pick up in H2 2019 given the increase in enquiries recorded for serviced-offices during H1 2019 predominantly from small-medium start-up firms.

Residential

We expect an average reduction of approx. 2% in residential rents for apartments, particularly 3-bedroom units as supply continues to outstrip demand in the prime residential suburbs. The increase in enquires for modern stand-alone houses registered in H1 2019 is expected to push up demand for the limited stock of existing modern stand-alone houses. This, in turn, is expected to positively impact house prices in the range of 5%-10%.

The above notwithstanding, as the suburbs closer to the CBD become densely commercialized, we expect

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residential developments to increase in peripheral locations to the CBD where rents are catching up with that of core locations.

Retail

The government in terms of its policy to promote local manufacturing increased import duties from 25% to 35% and 65% on a range of products in the latest fiscal budget. Processed foods will be most affected due to the imposition of a 60% import duty tax. These taxes will negatively impact on pricing as the associated costs will be passed on to the consumer. This will, in turn, have an impact on future inflation and it is still to be seen how robust the consumer is to absorb these additional costs.

Conclusion

Knight Frank anticipates the majority of real estate activity in terms of new developments and leasing in H2 2019 and beyond to hinge on the repercussions of the Landlord-Tenant bill if signed into law in its current state. As a result, Knight Frank forecasts a reduction in the intensity of leasing activity and pipeline development completions in the entire real estate sector as the bill in its current form, which bans rental income streams in USD will negatively impact investors, landlords, and developers with foreign currency debt. According to Bank of Uganda statistics, Uganda's real estate industry had an equivalent of approx. UGX 1.3 trillion of debt in USD as of April 2019, which investors, landlords, and developers could struggle to repay if they are unable to generate foreign currency incomes.

House for sale at Kabuuma Hill, Busabala

Marigold Heights, Plot 29D along Kira Road for rent.

A section of Fairside Homes, Plot **7409, Block 244, Muyenga for rent/sale.**

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UGANDA
Judy Rugasira Kyanda
Managing Director
+256 414 344 365
judy.rugasira@ug.knightfrank.com

RETAIL
Marc Du Toit
Head – Retail Property Management
+ 256 414 344 365
marc.dutoit@ug.knightfrank.com

VALUATION
Arafat Katugga
Head - Valuation
+256 414 341 391
Arafat.katugga@ug.knightfrank.com

AGENCY
Sharon Kamayangi
Head - Agency
+256 414 341 391
sharon.kamayangi@ug.knightfrank.com

CONSULTANCY
Francis Bbosa
Research Analyst
+ 256 414 344 365
francis.bbosa@ug.knightfrank.com

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